Supreme Court, U.S.
FILED

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No. _____

In The

Supreme Court of the United States

LAWRENCE JUST,

Petitioner,

v.

AUDREY MULLEN,

Respondent.

On Petition For Writ Of Certiorari To The New York Court Of Appeals

PETITION FOR WRIT OF CERTIORARI

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Pgs 26

QUESTION PRESENTED

1. Did the New York State courts incorrectly compute Petitioner's gross income, for purposes of child support, by refusing to deduct his subchapter S losses under 26 U.S.C. § 1361 of the Internal Revenue Code?

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PETITION FOR WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of certiorari issue to review the judgment and opinion of the New York State Court of Appeals, decided on March 26, 2002.

OPINIONS BELOW

Attached to this petition are the rulings of the (1) Hearing Examiner, (2) the New York State Family Court, (3) the New York State Supreme Court, Appellate Division, Second Department, and (4) the New York State Court of Appeals.

JURISDICTION

The order of the Court of Appeals was filed on March 26, 2002, and this petition for a writ of certiorari is being timely filed within 90 days thereof.

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

26 U.S.C. § 1361 of the Internal Revenue Code.

STATEMENT OF THE CASE

Procedural History

In a petition dated April 21, 1997, Respondent, Audrey Mullen commenced a support proceeding in New York State Family Court against Petitioner, Lawrence Just.

On March 31, 2000, Judicial Hearing Examiner, Barbara Lynaugh, entered Findings of Fact. On September 28, 2000, Suffolk County Judge Peter Dounias confirmed the Findings of Fact.

On November 26, 2001, the New York State Supreme Court, Appellate Division, Second Department, modified the ruling of Judge Dounias. On March 26, 2002, the New York State Court of Appeals denied leave to appeal.

Statement of Facts

Petitioner appeals to the Supreme Court of the United States from a denial of leave to appeal by the New York Court of Appeals.

It declined to review a ruling, by the New York State Supreme Court, Appellate Division, Second Department, which found no merit to Petitioner's claim that, for purposes of child support, his total income should be reduced by the flow through of his subchapter S losses.

At the support hearing, held before a Judicial Hearing Examiner, Just testified he was the Chief Financial Officer of Rodale Electronics, Inc. ["Rodale"] – a company that was

nearly insolvent (Transcripts, May 25, 1999: 49; July 8, 1999: 14).[1]

Due to reductions in defense spending, Rodale, which designs and manufactures electronic warfare equipment for the United States armed forces (Transcripts, July 8, 1999: 16), went from 200 employees and $10 million in sales in 1986, to 20 employees and $1 million in sales in 1999 (Transcripts, July 8, 1999: 19-20).

The company could not even pay vendors for raw material, to build its product, or meet weekly payroll (Transcripts, July 8, 1999: 26). Nor could it obtain bank financing after a negative audit in 1993, which questioned the long-term solvency of the corporation.

The only way it could now raise funds, and meet its obligations, as a subchapter S corporation (Transcripts, July 8, 1999: 17), was by turning to its two shareholders for capital contributions: John B. Clement, an eighty-six percent shareholder, and Lawrence Just, a 14 percent shareholder (Transcripts, July 8, 1999: 17).

In 1997, Just's W-2 wages were $88,492 (Transcripts, May 25, 1999: 48), but, after his capital contribution, his total income was reduced to $43,746 (Transcripts, July 8, 1999: 44).

Likewise, in 1998, his W-2 wages were $77,400.72 (Transcripts, May 25, 1999: 50), but, after his capital contribution, his total income was reduced to $30,790 (Transcripts, August 23, 1999: 20).

---

[1] Transcripts will be made available to the Court upon request.

The Judicial Hearing Examiner found that "[b]y making these payments, whether he [was] required to or not, respondent [was] making an investment in the company, increasing his equity interest therein with each dollar he provide[d] Rodale. If respondent were to purchase additional ownership interests in any of the companies in his expansive stock portfolio [in fact, he had none], these monies would certainly not be deductible from income for the purposes of calculating [Petitioner's] support obligation. There simply is no difference in the investment respondent is making in Rodale" (Findings of Fact: 3).

On September 28, 2000, Family Court Judge Peter Dounias confirmed the Hearing Examiner's findings of fact. On November 26, 2001, the New York State Supreme Court, Appellate Division, Second Department, modified the ruling,[2] but found this deductibility issue without merit. On March 26, 2002, the New York State Court of Appeals denied leave to appeal.

SUMMARY OF ARGUMENT

In calculating his child support payments, Petitioner should be allowed to deduct his subchapter S losses.

[2] It found the Family Court erred in two respects. First, it reduced counsel fees to $10,000 from $20,000. Second, it found it failed to credit investment expenses of $7,250, representing mortgage payments, when it calculated his total income for purposes of child support. *Mullen v. Just*, 288 A.D.2d 476 (2d Dept. 2001).

ARGUMENT

POINT 1

CERTIORARI SHOULD BE GRANTED TO DECIDE THE DEDUCTIBILITY OF SUBCHAPTER S LOSSES IN CALCULATING CHILD SUPPORT PAYMENTS, WHICH IS A CASE OF FIRST IMPRESSION IN THIS COURT.

The New York Judicial Hearing Examiner, the Family Court, the Appellate Division, and the Court of Appeals all incorrectly computed Appellant's gross income for purposes of child support, by failing to deduct his subchapter S losses.

The Supreme Court of the United States has never decided the deductibility of funded subchapter S losses in calculating child support payments.

Subchapter S of the Internal Revenue Code, 26 U.S.C. §§ 1361-1379, was enacted in 1958 to eliminate tax disadvantages that might dissuade small businesses from adopting the corporate form and to lessen the tax burden on such businesses. *Bufferd v. Commissioner of Internal Revenue*, 506 U.S. 523, 524-525 (1993). The statute accomplishes these goals by means of a pass-through system, under which corporate income, losses, deductions, and credits are attributed to individual shareholders in a manner akin to the tax treatment of partnerships. *Id.* (*citing* §§ 1366-1368).

The corporation's profits [or losses] pass through directly to its shareholders on a pro rata basis, and are reported on the shareholders' individual tax returns. *Gitlitz v. Commissioner of Internal Revenue*, 531 U.S. 206, 209 (2001) (*citing* § 1366(a)(1)(A)).

Each New York tribunal that addressed this issue erroneously calculated Appellant's support payments based on his W-2 wages, without first reducing his adjusted gross income by the amount of the losses in the subchapter S corporation. Clearly, a taxpayer is entitled to reduce his adjusted gross income by the amount of the losses of his subchapter S corporation. *Jackson v. Jackson*, 142 Misc. 2d 73, 75 (Sup. Ct. N.Y. Cty. 1988) ("A taxpayer is entitled to reduce her adjusted gross income by the amount of the losses of her subchapter S corporation"), *aff'd*, 157 A.D.2d 559 (1st Dept. 1990).

In characterizing the capital contribution as an "investment," the Hearing Examiner, the Family Court, and the Appellate Division, which found this argument lacked "merit," each, in turn, failed to recognize that the investment was immediately taken as a loss, and deducted by the taxpayer.

Such capital contributions are not "investments," because they are used to pay current bills for material, payroll and rent, during periods of insolvency. Appellant suffered real financial loss answering his employer's capital call. This was anything but an "investment."

The Hearing Examiner's claim that these capital calls, which were fully disclosed, increased Appellant's equity interest in Rodale is unsupported by the record. Appellant did not acquire more stock with each contribution; on the contrary, he simply paid corporate liabilities then due. Appellant's unsaleable stock ownership interest remained constant at 14% – both before and after the capital calls.

The Hearing Examiner also misapprehended Appellant's business purpose when she equated a capital call with a stock purchase. Appellant did not acquire an

additional equity interest in the company each time he answered a capital call from the company. Rather, he simply helped stave off near-certain insolvency.

Indeed, if a capital shortage precludes the corporation from paying salaries or wages, then the ten largest shareholders can be held personally liable for the payment. *See* New York Business Corporation Law § 630; *Weissman v. Sinorm Deli*, 88 N.Y.2d 437, 445 (1996).

The New York Courts also misapprehended the import of a subchapter S corporation. Under 26 Code of Federal Regulations 1.1366-1, "[a]n S corporation must report[,] and a shareholder is required to take into account in the shareholder's return, the shareholder's pro rata share, whether or not distributed, of the S corporation's items of income loss, deduction or credit described in paragraphs (a)(2), (3) and (4) of this section."

The non-discretionary language in this section ["must" "required"] prevents the S corporation from becoming a shelter of a payor's child support payments in the form of undistributed income or retained earnings. Subchapter S corporations are taxed, pro rata, to the shareholder, whether or not income is distributed. *Ellenbogen v. Computer Services, Inc. v. Hudacs*, 202 A.D.2d 825 (3d Dept. 1994).

Subchapter S losses are, unquestionably, exclusions from gross income. *McEwen v. Commissioner*, 249 A.D.2d 672 (3d Dept. 1998). Here, Just funded the corporation's losses, and, therefore, was entitled to take them as deductions against income.

In 1997, Just's W-2 wages were $88,492 (Transcripts, May 25, 1999: 48), but, after his capital contribution, his

total income was reduced to $43,746 (Transcripts, July 8, 1999: 44). In 1998, his W-2 wages were $77,400.72 (Transcripts, May 25, 1999: 50), but, after his capital contribution, his total income was reduced to $30,790 (Transcripts, August 23, 1999: 20). Clearly, child support must be based on the $43,746, in 1997, and the $30,790, in 1998, because this reflects Appellant's actual, total income, as reported on his federal income tax return.

For these reasons, the Supreme Court should grant certiorari, to finally resolve whether subchapter S losses should be deducted from income to calculate child support. Until then, the issue will have enormous national significance, for hundreds of thousands, if not millions, of men and women, throughout the United States, who may, as here, be paying child support they neither owe, nor can afford.

CONCLUSION

FOR THE REASONS SET FORTH ABOVE, THE WRIT OF CERTIORARI SHOULD BE GRANTED.

Dated: May 30, 2002
Roslyn, New York

Respectfully Submitted,

STEVEN A. FELDMAN
Attorney of Record for Petitioner

State of New York,
Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the twenty-sixth day of March 2002

Present, HON. JUDITH S. KAYE, *Chief Judge, Presiding.*

2-14 Mo No. 128
In the Matter of Audrey Mullen,
Respondent,
v.
Lawrence Just,
Appellant.

A motion for leave to appeal to the Court of Appeals in the above cause having heretofore been made upon the part of the appellant herein and papers having been submitted thereon and due deliberation having been thereupon had, it is

ORDERED, that the said motion be and the same hereby is denied.

/s/ Stuart M. Cohen
Stuart M. Cohen
Clerk of the Court

SUPREME COURT OF THE STATE OF NEW YORK

APPELLATE DIVISION: SECOND JUDICIAL DEPARTMENT

7850B
S/jv

_____AD2d_____ Submitted – October 25, 2001

FRED T. SANTUCCI, J.P.
LEO F. McGINITY
DANIEL F. LUCIANO
THOMAS A. ADAMS, JJ.

2000-09985

In the Matter of Audrey Mullen, respondent, v Lawrence Just, appellant.

DECISION & ORDER

Feldman and Feldman, Roslyn, N.Y. (Steven A. Feldman of counsel), for appellant.

Philip J. Castrovinci, Smithtown, N.Y. (Ruth Sovronsky of counsel), for respondent.

In a child support proceeding pursuant to Family Court Act article 4, the father appeals from an order of the Family Court, Suffolk County (Dounias, J.), dated September 27, 2000, which, *inter alia*, denied his objections to two orders of the same court (Lynangh, H.E.), both dated April 21, 2000, which awarded the petitioner child support based on a determination that his gross income for 1998 was $87,116.13, and a counsel fee in the sum of $20,000.

ORDERED that the order is modified, on the law and as a matter of discretion, by (1) deleting the provision thereof denying the appellant's objection to the order directing him to pay a counsel fee in the sum of $20,000,

and substituting therefor a provision sustaining the objection to the extent of directing him to pay a counsel fee in the sum of $10,000, and (2) deleting the provision thereof denying his objection to the order awarding the mother child support and substituting therefor a provision sustaining the objection to the extent of granting his application for a $7,250 mortgage payment credit against his investment income on his investment property; as so modified, the order is affirmed, without costs or disbursements, and the matter is remitted to the Family Court, Suffolk County, for further proceedings consistent herewith, including a new determination of child support.

"Although the matter of counsel fees is entrusted to the sound discretion of the trial court, it is 'nonetheless to be controlled by the equities of the case and the financial circumstances of the parties'" (*Kavanakudiyil v Kavanakudiyil*, 203 AD2d 250, 252, *quoting Maimon v Maimon*, 178 AD2d 635). Given the financial circumstances of the parties, as well as all the other circumstances of this case, the Family Court improvidently exercised its discretion in awarding the mother the sum of $20,000 in counsel fees (*see*, Domestic Relations Law § 237[a]; *Kwong-Yu Lee v Oi Wa Chan*, 245 AD2d 270).

The Family Court improperly calculated the father's income for purposes of determining his support obligation. Pursuant to Family Court Act § 413(1)(b)(5)(ii) a parent's income, for the purpose of determining his or her duty to support a child, shall include "investment income reduced by sums expended in connection with such investment". The Family Court failed to credit investment expenses in the amount of $7,250, representing mortgage payments, against the investment income which the father received from his investment property, when it calculated his total

income for purposes of child support. Thus, the matter is remitted to the Family Court, Suffolk County, for a recalculation of the father's income and his support obligation.

The father's remaining contentions are without merit.

SANTUCCI, J.P., McGINITY, LUCIANO and ADAMS, JJ., concur.

ENTER:

James Edward Pelzer
Clerk

November 26, 2001

FAMILY COURT OF THE STATE OF NEW YORK
COUNTY OF SUFFOLK

AUDREY E. MULLEN
Petitioner

Vs.

LAWRENCE JUST
Respondent

BY:
PETER DOUNIAS,. J.F.C.

DATED:
SEPTEMBER 27, 2000

DOCKET NO. P-671-97

Objections to the two orders entered on April 21, 2000 of Hon. Barbara Lynaugh, Esq., Hearing Examiner, having been filed with this Court, and said matter having come before me, the following disposition is made:

The respondent objects to the order of support which, *inter alia*, directed the respondent to pay child support for one child, born out of wedlock on May 8, 1997, in the amount of $1,600.00 per month ($220.00 towards arrears, $82.10 towards child care) and the order directing the respondent to pay counsel fees of $20,000.00 to the petitioner.

The respondent contends in his objections filed May 19, 2000 that the Hearing Examiner erred in calculating the respondent's prorata share of the basic child support obligation, and by awarding excessive counsel fees. The respondent also filed "Supplemental Objections" on August 17, 2000 which were untimely and were not considered by the Court in rendering this decision.

The petitioner filed a rebuttal on May 31, 2000 which contended that the respondent's objections were untimely, that the Hearing Examiner did not err in calculating the respondent's prorata share of the basic

child support obligation, and that the counsel fees awarded to the petitioner were not excessive. The petitioner also filed a "Response to Supplemental Objections" on September 1, 2000 which was untimely, and was not considered by the Court in rendering this decision.

Based upon a careful review of the record, including the transcripts of the hearing commenced on March 26, 1999 and continued on April 1, 1999, May 25, 1999, July 8, 1999, August 23, 1999, October 18, 1999 and concluded on March 2, 2000, the exhibits introduced into evidence at the hearing, the respondent's objections and the petitioner's rebuttal, the Court finds that the respondent's objections filed May 19, 2000 are not untimely, and are sustainable to the extent indicated below.

Dealing first with the issue of timeliness, the petitioner incorrectly states in her rebuttal that the order of child support was entered on April 2, 2000. In fact, the order objected to was entered on April 21, 2000 and mailed to the parties on that date. Therefore, the respondent's objections are timely. See, F.C.A. § 439(e).

Dealing next with the merits of the objections, the Court finds that the Hearing Examiner correctly calculated the gross (total) incomes of the parties, except for one item. The Social Security survivor benefits received by both parties on behalf of the surviving minor children of the parties respective deceased spouses, (who are not the subject of this proceeding) should not have been included in calculating the parties gross (total) incomes for 1998. The matter is remanded to the

Hearing Examiner to recalculate the parties incomes for 1998 and to enter an amended order of support.

The Court confirms the remainder of the Hearing Examiner's decision, and rejects the respondent's arguments that the Court should use I.R.S. definitions, rather than F.C.A. § 413(b) to determine the respondent's income. The respondent is an experienced Certified Public Accountant capable of earning at least $87,116.13 per year. As a father, he has a legal duty to support his child at a standard of living commensurate with his ability to pay.

Finally, the respondent claims that it was error for the Hearing Examiner to grant counsel fees to the petitioner without a hearing. However, the record reflects that both parties, represented by counsel, stipulated to submit the issue of counsel fees on papers only and waived the right to a plenary hearing (transcript of May 25, 1999, pages 31 through 35). While reviewing the petitioner's application for counsel fees, the Court found three instances where the petitioner claims legal fees for non-support related matters, namely July 29, 1998 (6 hours), January 6, 2000 (1.4 hours), and January 18, 2000 (1.10 hours). It appears that the Hearing Examiner deducted these 8.5 hours of non-support legal fees from the $23,263.69 requested by the petitioner and arrived at a reasonable award of $20,000.00. The Court notes that the respondent failed to submit opposition papers to the petitioner's application for counsel fees.

The Court has carefully considered all the respondent's remaining arguments, and finds them to be without merit.

The Clerk is directed to respectfully remand this matter to the Hearing Examiner to recalculate the parties 1998 incomes in accordance with this decision and enter an amended order of child support.

The foregoing constitutes the decision and order of the Court.

ENTER

/s/ Peter Dounias
J.F.C.

Section 439(e) of the Family Court Act provides as follows: "The final order of a Hearing examiner after objections have been reviewed by a Judge, may be appealed pursuant to article eleven of this Act."

FAMILY COURT OF THE STATE OF NEW YORK
COUNTY OF SUFFOLK

----------X

AUDREY MULLEN,

Petitioner,

-against-

LAWRENCE JUST,

Respondent.

----------X

FINDINGS OF FACT

Docket No. P-671-97

By petition dated April 21, 1997, petitioner seeks orders of filiation and support for one child, Grace Justine Mullen, born May 8, 1997. Paternity was established upon respondent's admission after the completion of blood tests following the child's birth. Following lengthy pretrial discovery, a hearing was eventually held on the issue of support. The hearing was quite protracted for a number of reasons, with seven days of testimony commencing on March 26, 1999 and concluding on March 20, 2000. Thereafter, respondent submitted a written summation. Petitioner, a widow with two other children, works part-time as an administrative assistant. She also has income from several other sources. Petitioner's income for 1998, the year for which both parties' income figures are most complete, was as follows: $4,242.61 (wages reported on W2 statement); – $263.05 – FICA deduction; – $61.53 – FICA deduction; $4,000 – unreported bonus; $17,916 – dividend income; $2,000 – interest income; $9,252 – Social Security survivor benefits for petitioner; $18,744 – Social Security survivor benefits for petitioner's two children; $1,350 – capital gains; $630 + $105 – refund for all taxes paid in

1997. Petitioner's total adjusted gross income for 1998 was $57,915.03.

Petitioner produced proof of the child care expenses she incurred for the subject child for the 11-month period from 3/27/98 to 2/25/99. These expenses total $1,481.25 for the 11 months or $134.66 per month. This annualizes to $1,615.92 per year [$134.66 x 12].

Respondent, a widower with another child, is the chief financial officer and a 14% shareholder of Rodale Electronics. Respondent receives a W2 employee wage statement from Rodale. His 1998 W2 reports wages of $77,401, with FICA deductions of $4,240.88 and $1,219.99. Added to this income are the fringe benefits respondent receives from Rodale, including $1,000 in car insurance; $2,000 imputed yearly value of the 1994 Pontiac respondent drives, which was purchased by Rodale for $15,000; $500 in gas (a conservative figure); $500 in meals locally; and $750 in meals while on business trips. Respondent's 1998 tax return indicates additional income of $588 in interest; $330 in dividends; $1,769 in tax refunds; and $7,740 in rental income from the Born Free motel in Montauk, after operating expenses only, the mortgage interest and depreciation deducted on respondent's Schedule C are not unreimbursed business expenses. The total of the above figures is $87,116.13. Respondent has additional income of $5,160 in Social Security survivor benefits for his son ($430 per month, as indicated on Respondent's T), making respondent's total adjusted gross income $92,276.13 per year.

Respondent claims that he is required to "contribute" substantial sums of monies to Rodale, in proportion to his percentage of ownership, to cover any shortfall the

company experiences in its cash flow. In 1997, respondent "contributed" $40,000 to Rodale. In 1998 (while this litigation was well under way), respondent made total of $91,000 in cash payments to the company, utilizing $50,000 from a 401K, cash advances from credit cards, and liquidated investments. Respondent argues that these sums should be deducted from his income alleging they are unreimbursed business expenses.

The Court disagrees. By making these payments, whether he is required to or not, respondent is making an investment in the company, increasing his equity interest therein with each dollar he provides to Rodale. If respondent were to purchase additional ownership interests in any of the companies in his expansive stock portfolio, these monies would certainly not be deductible from income for the purposes of calculating respondent's support obligation. There simply is no difference in the investment respondent is making in Rodale.

The combined parental income is $150,191.16 per year [$57,915.03 + $92,276.13], of which petitioner earns 39% and respondent earns 61%. The combined parental support obligation for the one child based on this income is $25,532.50 per year [$150,191.16 x 17%]. Respondent's pro rata share of this obligation is $15,574.83 per year [$25,532.50 x 61%] or $1,297.90 per month [$15,574.83 ÷ 12]. Respondent's pro rata share of the child care expenses is an additional $985.71 per year [$1,615.92 x 61%] or $82.10 per month [$985.71 ÷ 12], making a total obligation of $1,380 per month.

In reaching this determination, the Court applies the statutory percentage to the full amount of the combined parental income, including that portion which is above

$80,000 per year. Respondent made no argument in support of limiting the pro rata support contribution to combined parental income of $80,000, and, in fact, acknowledges in summation that an application of the statutory percentage of combined income above $80,000 may be appropriate herein. There is little in the record which would enable the Court to do a detailed analysis of the factors set forth in F.C.A. § 413(1)(f) to support a finding that the application of the statutory formula to the entire combined parental income would be either unjust or inappropriate.

In fact, one relevant factor therein, F.C.A. § 413(1)(f)(7), "a determination that the gross income of one parent is substantially less than the other parent's gross income," would appear to cry out for an application of the statutory formula to the full amount of the income. Respondent's income is close to 60% higher than that of petitioner. To provide this child with a standard of living commensurate with the far superior means of respondent, petitioner requires a support order based on the full statutory percentage applied to the entire combined parental income.

Indeed, it is clear that the Child Support Standards Act, embodied in F.C.A. § 413, was meant to be a legislative statement not only if the presumed needs of the child *vis-a-vis* the total income available to the parents but also of the standard of living that should be shared with a dependent child. It is precisely because of its uniformity and predictability that there is to be a presumption in favor of the application of the statutory formula in all cases.

In view of the foregoing, an order will enter in the amount of $1,297.90 per month, retroactive to May 8, 1997, the child's date of birth. The order will be amended to $1,380 per month, to include a pro rata child care contribution of $82.10 per month, as of April 8, 1998, the closest monthly payment date to the time when petitioner first began incurring child care expenses.

The total amount due for child support for the 37 months from 5/8/97 to 5/8/00 is $48,022.30 [$1,297.90/mo x 37]. The total amount due for child care for the 26 months from 4/8/98 to 5/8/00 is $2,134.60 [$82.10/mo x 26]. The total amount due is $50,156.90 [$48,022.30 + $2,134.60]. As of 5/25/99, respondent had paid $9,030 to petitioner. Respondent, presumably, has continued making, and will continue to make, the $100 weekly payments required by the temporary support order for the additional 54 weeks through 6/2/00. This will be an additional amount paid to petitioner of $5,400 [$100 x 54]. Therefore, total payments made through 6/2/00 will be $14,430 [$9,030 + $5,400], leaving retroactive arrears of $35,726.90 [$50,156.90 - $14,430].

The order will be made payable through the Support Collection Unit (SCU), on consent of the parties, effective June 8, 2000. Respondent is to make a lump sum payment of $20,000 towards the arrears through SCU within sixty (60) days of service with notice of entry. The balance of the arrears are to be paid at a rate of $220 per month, through SCU, effective 6/8/00, making a total monthly payment of $1,600, allocated at $1,297.90 for support, $82.10 for child care, and $220 for arrears.

Dated: March 31, 2000

/s/ Barbara Lynaugh
BARBARA LYNAUGH
HEARING EXAMINER

Supreme Court, U.S.
FILED
JUL 8 2002
CLERK

(2)

No. 01-1771

IN THE

Supreme Court of the United States

LAWRENCE JUST,

Petitioner,

v.

AUDREY MULLEN,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF NEW YORK, APPELLATE DIVISION SECOND DEPARTMENT

BRIEF IN OPPOSITION

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The sole issue presented by the Petitioner is whether the New York Court, in calculating his income for purposes of computing his child support obligations, properly declined to deduct, dollar-for-dollar, the amount of Petitioner's voluntary and unilateral "capital contributions" made to Rodale Electronics, his own company.

Respondent, Audrey Mullen, submits that the petition for writ of certiorari should be denied. State Courts have an overwhelming and overriding interest to safeguard the rights of children to receive adequate support from non-custodial parents. The State Courts must retain the ability to resolve questions of credibility of litigants in all cases and cannot be bound by the amount of income or loss reported by a self-employed parent in his tax returns. To require the States to be bound by a litigant's computation of his or her 'income' would curtail the State's interest in fixing child support obligations that reflect the true financial circumstances of the obligor parent.

The Courts of New York State correctly rejected the Petitioner's unilateral computation of his income, in his attempt to reduce his income so as to minimize his child support obligations.

STATEMENT OF THE CASE

Petitioner is the owner of his own business, Rodale Electronics, responsible for all financial operations. In 1997, Petitioner's income from Rodale, as reported on his W-2 form, was in the sum of $88,492. (Transcripts, May 25, 1999: 48) In that same year, the Petitioner claimed that he made necessary "capital contributions" to Rodale in the sum of $41,767, (Transcripts, July 8, 1999: 45) and argued that

his total income in 1997 should be the difference, or the sum of $43,746. Similarly, for 1998, Petitioner insisted that his child support obligation should be based upon the even lower income of $30,790, which he computed by deducting optional contributions made to his own company from W-2 income he had received in that year. (Transcripts, August 23, 1999: 35) In computing his available income for child support, however, Petitioner did not include any of the multiple perquisites provided by his own company. (Transcripts, August 23, 1999: 34, 35)

As a 13.95% shareholder, Petitioner insisted that he was obliged to contribute funds in accordance with his ownership interest in the company. Petitioner asserted that his co-owner, John Clement, an 86% owner, had made similar contributions in accordance with his ownership interests. (Transcripts, July 8, 1999: 27, 28)

Petitioner further took the position that the capital contributions from each partner were obligatory, but he was unable to point to any document that supported his claim. At one point, Petitioner insisted that the Shareholder's Agreement compelled such payment, but on cross-examination, he was compelled to admit that nothing in the Shareholder's Agreement required such a contribution. (Transcripts, March 2, 2000: 5)

The testimony at the hearing made it apparent that the Petitioner had the ability to unilaterally control the amount and frequency of his "contributions." His contributions were voluntary, varied and did not follow a set pattern. Petitioner's sole witness, his assistant Terry Colford, was obliged to confirm that Petitioner's "contribution" depended upon whatever amount he felt was required at any given point in time. (Transcripts, March 2, 2000: 32, 33)

Petitioner nevertheless continued to insist that all contributions to his business should be deducted, dollar-for-dollar, from his annual income for the purposes of computing his child support obligations. However, it was revealed that such contributions were *not* deducted from his corporate income, were NOT taken from his W-2 income, and were not mandatory. Further questioning compelled Petitioner to concede that virtually all contributions were made out of other existing assets. (Transcripts, July 8, 1999: 52; August 23, 1999: 10, 18)

Although petitioner insisted that contributions were compelled by the "near insolvent" state of his business, he never produced any books or records of the business, and never produced any proof in support of such claims, relying solely upon his own self-serving testimony. While claiming that his company's financial difficulties required an infusion of capital, he offered no documentation to prove such claims. Although he claimed that his capital "contributions" were used to pay expenses of the company, Petitioner refused to produce the books and records of the business. Petitioner further elected NOT to produce his partner, Mr. Clement, as a witness. In short, the "contributions" made to the company from Petitioner's other investments and assets might well have been nothing more than a movement of capital from one asset to another in order to create a paper "loss". Indeed, the funds could well have been transferred to other investments held by Rodale.

On cross-examination, it became apparent that Petitioner's claims of reduced income were not matched by any deterioration in his standard of living. While testifying that his income had steadily declined since 1994 (Transcripts, July 8, 1999: 23-25), such decline did not dissuade Petitioner from *increasing* his personal expenditures.

On cross-examination, it was disclosed that in 1997, the very year in which he claimed the need to make a capital contribution of $41,767 to rescue his corporation from "near insolvency", the Petitioner also made the decision to purchase a new home, increasing his monthly mortgage from $500 to $2,200, a four-fold increase. Refusing to offer any explanation for his actions, Petitioner confirmed that in 1997, he sold the house he had owned and occupied for twenty years (Transcripts, October 18, 1999: 10) with a mortgage balance of $8,000 and a monthly obligation of $500, and bought a new home with a mortgage of $184,000 and monthly payments of $2,2000. (Transcripts, October 18, 1999: 9-13)

Depositions revealed that upon the sale of his house, Petitioner received a net of approximately $145,000 in cash. He elected to take out a very substantial mortgage rather than utilize the proceeds from the sale to reduce the new mortgage obligation and his monthly payment. This was inconsistent with Petitioner's claims of dramatic financial losses.

Testimony disclosed that Petitioner was current in all of his personal mortgage payments, and was "never more than thirty days late" with a payment. (Transcripts, October 18, 1999: 29-30) It was further revealed that in 1999, he was continuing to make regular contributions to his 401K plan (Transcripts, October 18, 1999: 31), and that contributions made by any corporate employee were matched by the corporation. (Transcripts, March 2, 2000: 59-60)

REASONS FOR DENYING THE WRIT

In computing the amount of Petitioner's income for purposes of calculation of his child support obligation, the Court exercised its discretion not to accept statements set forth in the Petitioner's tax return. The Court further exercised its authority to impute income to the Petitioner based upon his *ability* to earn, rather than his self-serving claims of manipulated income.

In order to serve the best interests of children and to ensure that children are supported in accordance with their parents' true financial ability, State Courts must be free to disallow items that appear contrived or manipulated to create the illusion of reduced income.

It is of paramount importance that the State Courts, in order to protect the rights of its children to receive adequate support from parents, retain the right to find a litigant's testimony unworthy of credibility, whether such testimony consist of open-court sworn testimony or statements made in a tax return prepared by or on behalf of a self-employed taxpayer.

Accordingly, based upon all available testimony, the New York Courts properly found Petitioner's representations of his own income to be inaccurate and misleading.

I.

THIS CASE INVOLVES THE APPLICATION OF THE WELL-ESTABLISHED RULE THAT A TRIAL COURT MUST HAVE THE POWER TO FIND TESTIMONY INCREDIBLE

The Courts must have the power to make independent determinations as to the credibility of a litigant. Inherent in such power is the ability to reject statements or computations of income and/or losses set forth in a tax return.

A. Statements Made In A Tax Return Are Properly Subject To Review and Challenge For Purposes of Credibility

The Petitioner's position that all statements on a litigant's tax return, including statements of sub-chapter S corporate losses, should be taken at face value, finds no support in the law. The mere fact that an item appears as a "deduction" on a tax return does not then automatically require a Court or even the Internal Revenue Service to accept the return or the claimed "loss" at face value. Indeed, the Internal Revenue Service regularly audits returns and, notwithstanding the definitions of "income" as set forth in the Code and Regulations, may conclude with a determination that conflicts with the taxpayer's own calculation of income.

The definition of "income" and "losses", as set forth in Internal Revenue Code and Regulations cannot be interpreted in such a manner as to restrict the ability of any reviewing tribunal, whether a State Court or the Internal Revenue Service, to reject a taxpayer's self-serving claims.

A Court is not required to accept a party's account of his or her own finances, and Courts have frequently observed that figures set forth on tax returns do not have to be accepted as income in determining child support obligations. *Liebman v. Liebman*, 229 A.D.2d 778, 645 N.Y.S.2d 581 (3d Dep't 1996.) There is nothing in any statute that requires a Court or other reviewing tribunal to accept tax returns at face value, nor should the State Court be bound to do so.

In computing income for the purposes of determining child support obligations, the Courts frequently look beyond the information set forth in a tax return. The Court can, for example, add into income any personal expenses paid by a corporation, even if such items are not listed on the tax return. *Comm. Of Soc. Services on behalf of Bryan S. v. Richard S.*, 135 Misc.2d 98, 515 N.Y.S.2d 168 (St. Lawrence Co., Family Court 1987.)

It is acknowledged that Petitioner's business is structured as a subchapter S corporation. As such, the Courts of New York and other jurisdictions have held that passive income from a subchapter S corporation does constitute income for the purposes of determining child support. *Gianniny v. Gianniny*, 256 A.D.2d 1079, 683 N.Y.S.2d 769 (4th Dep't 1998). *Anderson v. Anderson*, 60 Ark. App. 221, 963 S.W.2d 604 (1998), *Labar v. Labar*, 557 Pa. 54, 731 A.2d 1252 (1999).

However, the Courts have also held that corporate losses claimed on a tax return will not and should not automatically serve as a reduction in income for purposes of computing child support, where the husband has continued to receive a salary from the corporation and his lifestyle remains

unchanged, *Kuhn v. Bovier*, 268 A.D.2d 806, 701 N.Y.S.2d 748 (3d Dep't 2000) or where such claimed losses do not impact upon actual earnings or do not represent actual reductions in a support obligor's personal income. *Labar v. Labar*, 557 Pa. 54, 731 A.2d 1252 (1999)

Where it is demonstrated that a party's income, spending and resources are greater than those reported on a tax return, or where that party's lifestyle is at odds with information reported on a tax return, the Court cannot and should not be bound by the information contained in the return. *Hoenig v. Hoenig*, 245 A.D.2d 262, 664 N.Y.S.2d 823 (2d Dep't 1997.) The mere fact that an item appears on a tax return should not be conclusive or binding upon a Court's determination of income for the purposes of determining a child support obligation.

II.

THE STATE COURTS, IN ORDER TO SAFEGUARD THE RIGHTS OF CHILDREN TO RECEIVE ADEQUATE SUPPORT FROM PARENTS, MUST HAVE THE POWER TO UTILIZE BROAD DEFINITIONS OF INCOME AND TO IMPUTE INCOME TO A PARENT BASED UPON ABILITY TO EARN

In child support proceedings, the Court must be permitted to utilize the broadest possible definition of income so as to ensure that litigants are not given the ability to manipulate their earnings for purposes of minimizing child support obligations.

Giving the State Courts broad authority to define the "income" of a parent obliged to pay child support requires that the Courts have the ability to disallow otherwise appropriate deductions from the computation of a litigant's income. What may be "deductible" as an offset against income in accordance with the Internal Revenue Code may be and properly should be disallowed when computing income for purposes of child support.

For example, the Courts of various jurisdictions, including New York, have clearly held that depreciation, while an allowable deduction under the Internal Revenue Code, will not be considered as a deduction against income and will not be considered in computing a parent's ability to pay child support. *Haas v. Haas*, 265 A.D.2d 887, 695 N.Y.S.2d 644 (4th Dep't 1999), *Baraby v. Baraby*, 250 A.D.2d 201, 681 N.Y.S.2d 826 (3d Dep't 1998), *Blaise v. Blaise*, 241 A.D.2d 680, 659 N.Y.S.2d 926 (3d Dep't 1997), *Labar v. Labar*, 557 Pa. 54, 731 A.2d 1252 (1999), *Smith v. Smith*, 2001 WL 459108 (Tenn. Ct. App.)

The rationale for such a rule is that depreciation deductions do not reflect an actual out-of-pocket expenditure that results in an actual reduction of the personal income of the party claiming the deduction. *Cunningham v. Cunningham*, 378 Pa. Super. 280, 548 A.2d 611, *alloc. denied*, 522 Pa. 576, 559 A.2d 37 (1989).

There are other necessary and fundamental differences between the definition of 'income' for purposes of computation of child support and the definition of 'income' for purposes of computing tax consequences. For example, the specific language of the Child Support Standards Act as enac d in New York permits the Court to compute income

based upon the income that was "*or should have been reported*" on the parent's last tax return. Family Court Act Section 413 paragraph 1(b)(5)(i). The Child Support Standards Act permits a Court to impute income to a non-custodial parent based upon what he *could* earn. By contrast, in defining income, the Internal Revenue Code does not tax potential, unrealized income or ability.

Similarly, a Court may include, as income, regular gifts or ongoing support received from a parent or other family member, while this would not constitute "income" under I.R.S. definitions. *Johnson v. Robusto*, 254 A.D.2d 828, 678 N.Y.S.2d 178 (4th Dep't 1998.)

A deduction for a bad debt, while allowable by the Internal Revenue Code as a deduction, is not permitted as a deduction against income, for the purposes of computing child support. *Carlson-Subik v. Subik*, 257 A.D.2d 859, 684 N.Y.S.2d 65 (3d Dep't 1999.) Similarly, a poor investment, resulting in a capital loss, should not be used to reduce one's income.

In making his argument, Petitioner urges that the Internal Revenue Code must be deemed the decisive indicator of what is or is not considered income for purposes of child support. Taking this argument to its logical conclusion would result in a situation in which a devious parent, looking to minimize his obligations to his children, could manipulate his finances in such a manner as to make it appear that he had no income at all.

Assume, for example, that a parent has an income of $100,000 per year. In one year, the parent elects to sell securities valued at $300,000, claiming a $100,000 loss on

the sale. Should this parent nevertheless be entitled to offset his annual income with the amount of such a claimed "capital loss"? Would this parent's income be deemed "zero" thus relieving him of all support obligations? Logic dictates that this question must be answered in the negative. It is apparent that a decline in the value of assets owned by a litigant has no bearing on income earned by that litigant.

In furtherance of its obligation to protect the rights of children to receive proper support from parents, the Courts are given and must be able to retain the right to impute income to a parent and fix support on the basis of that parent's ability to earn, rather than his actual statement of earnings. Without such ability, there would be nothing to prevent an uncooperative parent from taking a low-paying job or refusing to seek gainful employment, in order to limit his or her obligations to pay child support. The State Courts must be permitted to utilize definitions of income that are broadly construed and not limited by statements of income set forth in a tax return. Income should be imputed, for example, where the Court finds that the parent's claims of income are not in accordance with expenditures or standard of living.

In this case, not only did the Court reject statements contained in Petitioner's tax returns, but the Court determined that Petitioner's income as set forth in his W-2 reported earnings of $77,400.72 were consistent with his ability to pay support on behalf of his child.

Petitioner, who insists that for purposes of computing his child support obligations, his income was not greater than $30,790 in 1998, ignored the fact that he is a highly trained professional, with advanced degrees in tax and accounting,

and is licensed as a Certified Public Accountant. By his own testimony, Petitioner had worked for the renowned accounting firm of Coopers & Lybrand.

Judge Dounias, after reviewing all of the Petitioner's objections, made an affirmative finding that the Petitioner "is an experienced Certified Public Accountant capable of earning at least $87,116.13 per year." This finding of fact focused upon the Petitioner's *ability* to earn, given his compelling credentials and impressive experience.

To the extent that a business generates less income than might otherwise be realized, the Courts in New York State have held that a parent's obligation to pay child support is measured by his *ability* to earn, not necessarily the amount of income claimed. *Kay v. Kay*, 37 N.Y.2d 632, 376 N.Y.S.2d 443 (1975.) If a business is not prospering, then it is incumbent upon that parent to secure income commensurate with his qualifications and experience. Indeed, a Court should not be bound by the convenient and possibly contrived claim that a parent has "no income" due to the failure of his business. *Orlando v. Orlando*, 222 A.D.2d 906, 635 N.Y.S.2d 752 (3d Dep't 1995.)

Courts have the ability to impute income to a litigant on the basis of unreported or under-reported business activity, *Klein v. Klein*, 251 A.D.2d 733, 674 N.Y.S.2d 142 (3d Dep't 1998), or where the court finds that personal expenditures are charged to a business account, or paid by a business. *Barber v. Cahill*, 240 A.D.2d 887, 658 N.Y.S.2d 738 (3d Dep't 1997.) Critical to such authority is the fact, as noted by the Courts, that self-employment carries with it the ability to manipulate one's own finances. *Posson v. Posson*, 229 A.D.2d 690, 645 N.Y.S.2d 155 (3d Dep't 1996.)

After considering the relevant facts and applicable law, the State Court properly held that the Petitioner had failed to substantiate his claims of "losses" with actual documentation, testimony other than his own, or proof of any decline in his standard of living. The Court properly imputed income to the Petitioner based upon his ability, experience and demonstrated lifestyle. This is not, as Petitioner suggests, an aberration or a travesty that will send the child support world into a tailspin. To the contrary, to grant Petitioner's application would result in the potential inability of State Courts to make awards of child support in accordance with a parent's true financial circumstances.

CONCLUSION

For all of the foregoing reasons, Respondent respectfully requests that this Honorable Court deny the Petition.

Respectfully submitted,

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